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Recent Contributions of Small Businesses and Corporations to Rural Job Creation

James P. Miller

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nonmetro areas between 19 ...
expanding rapidly. Those ...
created jobs at a net rate of 76 percent. Multi-establishment firms (called corporations in this report) accounted for about 68 percent of the net increase in nonmetro jobs during 1976-80. Small corporations created almost 14 percent of the new jobs and large corporations (those with 100 or more employees) created 54 percent.

Keywords: Job generation, nonmetro, metro, small business, corporation, corporate affiliates.

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INTRODUCTION

The traditional approach to building a stronger rural economy is to attract industry from the outside, inducing national or regional corporations to establish branches in rural areas. There has been a recent surge of interest in the role small, locally owned businesses can play in rural development. Some rural officials and business leaders want to reduce the influence of the large corporation in their communities by encouraging more local entrepreneurship. They believe their community will be less prosperous and more unstable if it relies too heavily on branch plants of large national corporations instead of striving for more self-sufficiency by promoting small businesses (6, 8, 12).[1]

Several events have contributed to the interest in small business. The threat of "deindustrialization" in America has fueled the hope that an expansion of small businesses could offset a perceived net loss of employment in absentee-owned corporate branches and subsidiaries. In recent years, many manufacturing jobs may have been permanently lost in rural areas as national corporations phased out and closed branch plants in favor of foreign locations offering cheaper labor and fewer safety and environmental restrictions. While there are no reliable estimates of gross job losses for rural areas, Bluestone and Harrison estimated that during the seventies, "between 450,000 and 650,000 jobs in the private sector in both manufacturing and nonmanufacturing were wiped out somewhere in the United States by the movement of large and small runaway shops (5, p. 25)."[2]

Birch, a researcher at the Massachusetts Institute of Technology, found that more than 80 percent of the new jobs (the net increase) in the United States between 1969 and 1976 were created by firms with fewer than 100 employees (4). This finding has been widely cited in speeches, newspapers, and journals to help build the case for more local entrepreneurship and investment in small business. A closer look at Birch's results, however, reveals that only 56

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[1]Underscored numerals in parentheses refer to items in the References section.

[2]While no reliable data exist on the impact of plant closings in rural communities, there is some evidence to suggest that small rural communities may be hurt more than other communities. One closing of a textile plant in North Carolina, for example, a plant that once hired 1,000 people, eliminated 492 jobs in a community of 752 residents in a county that has only about 35,000 residents (13).

percent of the new jobs were generated by small businesses, that is, independent (single-establishment) firms with fewer than 100 employees.[3]

The third event that stimulated interest in small business was the introduction of the "enterprise zone" concept. The concept as proposed in 1980 by Stuart Butler, a British economist, was to be an experiment in reduced government (7). Tax incentives and deregulation would be used to encourage small indigenous businesses to develop within distressed urban core areas. Legislation to create enterprise zones has been proposed in Congress and several State legislatures. The Reagan administration's enterprise zone bill (s.863/ h.r.4576), yet to be reported out of the House Ways and Means Committee, would authorize 75 enterprise zones in the country over a 3-year period; 24 of them are proposed for rural areas. The program would provide tax incentives and relax Federal regulations to stimulate small business investment in the zones.

Several State enterprise zone bills have already been passed. States have activated enterprise zones in areas ranging from inner cities to distressed rural communities. Two States, Missouri and Kansas, have rural enterprise zones.

In addition to the enterprise zone approach, States and municipalities have moved rapidly to establish other incentive programs targeted to small business. Umbrella bond issues of industrial revenue bonds (IRB's) are being used to provide loan funds for small businesses needing startup or growth capital.[4] Several States have chartered development credit corporations that "pool" loans from several lenders to help finance small businesses. Incubator facilities have been opened to provide low rent space, centralized services, flexible leases, and management advice to very small, young businesses.

This report describes the structure of the job generation process in rural areas during a period of rapid employment growth: the number of jobs that small businesses, large independent businesses, and corporate affiliates generate and the stability of these jobs.[5] It attempts to shed light on several questions. When employment is expanding rapidly, how important are small businesses as sources of new jobs in rural areas? Are they more likely

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[3]Using data from Dun and Bradstreet, Birch shows that about 82 percent of the net employment change (1969-76) was generated by small (fewer than 100 employees) establishments. However, not all of these establishments are small local firms with no outside corporate ties. Of the 82-percent share of growth, about 26 percentage points were due to small affiliates of large companies. Small independent (single-establishment) firms thus generated only 56 percent of net employment growth.

[4]Small companies with short track records in the business world are typically limited to traditional high-interest debt financing through commercial lending institutions. An umbrella bond issue is an alternative method for financing small businesses. Tax-exempt IRB's are pooled into a single issue to provide low-interest loans for several small business projects. A bank letter of credit or credit insurance is used to back the issue to make it more marketable.

[5]This report uses the terms "rural and urban" interchangeably with "nonmetro" and "metro." Metro counties are those designated as being in Metropolitan Statistical Areas (MSA's) by the U.S. Office of Management and Budget in 1980. Of the 3,141 U.S. counties, 725 were metro and 2,416 were nonmetro.

to generate jobs than affiliates of large corporations? Will these businesses (and the jobs they create) still be around 5 years later?

The tabulations were developed from a large data base--U.S. Establishment and Enterprise Microdata (USEEM)--created by The Brookings Institution for the Small Business Administration to examine the growth behavior of small businesses in the United States. The USEEM files contain microdata on essentially the universe of business establishments in the private sector--about 5 million establishments--for 1976 and 1980. The files were derived from Dun and Bradstreet (Duns Market Identifier) files.[6]

SMALL AND CORPORATE BUSINESSES DEFINED

"Small business" in this report refers to an independent (single-establishment) firm with fewer than 100 employees. Given the limitations of the Dun and Bradstreet coding system, we believed small establishments not affiliated with a multi-establishment firm accurately represent the target group of most small business development programs: small, independent firms, locally owned and operated, with no outside company ties.[7] This small business definition excludes all companies with affiliates (branches and subsidiaries) and all independent single-establishment firms with more than 100 employees. Multi-establishment companies are referred to as corporations in this report for ease of exposition and because most of these businesses are incorporated.

The firm instead of the establishment is used here as the unit of classification because it is the entity that owns, controls, and operates business establishments. The size of firm is measured by the number of employees in the entire firm's work force in all its affiliates. The rationale for focusing on size of firm instead of size of establishment to track employment growth in small businesses has been clearly set forth by Armington and Odle while at the Brookings Institution:

> It is the parent firm that makes the business policy decisions that determine much of the behavior of the neighborhood branch of the department store, the business office of the telephone company, or the local cannery of a large food-processing company. Similarly, most government policies affecting businesses are directed at the legal and financial entity, the parent firm. So although the number of employees at the establishment location may be the appropriate unit of measure for studies of management techniques or sociology of the work place, the size of the entire firm's work force is the preferable measure for evaluating the effects of public policy on small business and assessing the impact of the small-business sector on the economy (2, p. 14).

These researchers discovered that many jobs that appear to be in small businesses are actually jobs in small affiliates of large corporations. In the United States, small establishments (fewer than 100 employees) generated about

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[6]For more information on the Dun and Bradstreet files and the Brookings USEEM extract, readers are encouraged to refer to (1 and 11).

[7]Dun and Bradstreet uses three codes to identify an establishment's ownership status: (1) not multi-unit affiliated (single location), (2) headquarters location of multi-unit operation, and (3) branch location of multi-unit operation.

78 percent of the private-sector jobs between 1978 and 1980; however, about 40 percent of these jobs were created by small affiliates of large corporations.

SMALL BUSINESS VERSUS THE CORPORATION: GROWTH SHARES

Small businesses generated approximately 31 percent of the net increase in private sector jobs in nonmetro areas during the rapid 1976-80 employment growth. Corporate affiliates generated 68 percent of the increase, while large independent firms (more than 100 employees) contributed only 1 percent (table 1). Small businesses contributed less to net employment growth in nonmetro areas than did corporate affiliates in all major industry divisions except contract construction during 1976-80 (fig. 1). In the three industries that generated most of the jobs in rural counties (services, manufacturing, and trade), the small business contribution to growth was 33, 19, and 28 percent, respectively (fig. 2). The pattern was similar in the other major industries except construction where small firms generated about 60 percent of the rural jobs.

Small businesses during 1976-80 contributed more to net employment growth in metro than nonmetro counties, about 40 percent of the total, compared with 31 percent. Their contribution to job growth varied by major industry but was higher in metro than nonmetro areas in all industries except one (fig. 2). The greatest difference was in manufacturing where the small firms' share of net growth was about 46 percent in metro counties and only 18 percent in nonmetro counties.

The transportation, communications, and public utilities sector was the only major sector where small, independent firms were less important in creating jobs in metro than in nonmetro counties. These firms accounted for 19 percent of the net job growth in metro areas and 25 percent in nonmetro counties.

IMPORTANCE OF THE CORPORATE FIRM IN RURAL JOB GROWTH

From 1976 to 1980, small corporations created net new jobs in their branches and subsidiaries at nearly double the rate of small independent firms in nonmetro counties, 29 percent compared with 15 percent (table 1). Affiliates of large corporations expanded employment by 20 percent, whereas the rate for large independent firms was less than 2 percent. The overall rate of increase in rural corporate firms was 21 percent, compared with an overall rate of 12 percent in independent firms.

Corporations created jobs at a slower pace in metro counties (15 percent) than in nonmetro counties (21 percent). The rate of expansion by small metro businesses, however, approached 22 percent, compared with less than 15 percent by small nonmetro businesses.

The corporate share of employment growth in metro counties was 63 percent, compared with 68 percent in nonmetro counties. Affiliates of large corporations generated approximately 51 percent of the net growth in metro counties, less than their 55-percent share in nonmetro counties.

These findings on the source of employment growth in the late seventies lend support to the "incubator/filter-down" hypothesis which holds that corporations at a certain stage of their industry's product life cycle tend to branch out to low-wage surburban and rural locations, whereas small independent

Table 1—Changes in private sector employment by size and type of firm, nonmetro and metro counties, 1976-80

Item	1976		Net change 1976-80			Rate of job creation 1/	Rate of job loss 2/
	Employees	Share	Employees	Rate	Share		
	Thousands	Percent	Thousands	Percent			
United States	76,202	—	11,682	15.3	—	43.9	28.6
Nonmetro counties 3/	15,635	100.0	2,676	17.1	100.0	43.1	26.0
Independent firms	7,141	45.7	850	11.9	31.9	35.9	24.0
Small 4/	5,555	35.5	823	14.8	30.7	40.5	25.7
New 5/	1,460	9.3	1,113	76.3	41.6	106.9	30.6
Older	4,095	26.2	-290	-7.1	-10.9	16.9	24.0
Large	1,586	10.2	27	1.7	1.0	19.5	17.8
New	130	.8	56	43.3	2.1	77.8	34.5
Older	1,456	9.3	-29	-2.0	-1.1	14.3	16.3
Corporate affiliates	8,494	54.3	1,826	21.5	68.1	49.2	27.7
Small	1,269	8.1	364	28.7	13.6	59.4	30.7
Large	7,225	46.2	1,462	20.2	54.6	47.4	27.2
Metro counties	60,567	100.0	9,006	14.9	100.0	44.2	29.3
Independent firms	23,133	38.2	3,344	14.5	37.1	39.8	25.3
Small	16,318	27.0	3,571	21.9	39.7	47.9	26.0
New	4,381	7.2	3,912	89.2	43.4	122.6	33.3
Older	11,937	19.7	-341	-2.9	-3.8	20.4	23.3
Large	6,815	11.2	-227	-3.3	-2.5	20.2	23.5
New	634	1.0	301	47.5	3.3	87.5	40.0
Older	6,181	10.2	-528	-8.6	-5.9	13.2	21.8
Corporate affiliates	37,434	61.8	5,662	15.1	62.9	46.9	31.8
Small	4,070	6.7	1,109	27.2	12.3	58.8	31.6
Large	33,354	55.1	4,553	13.7	50.6	46.3	32.6

Note: Column entries may not add exactly to totals because of rounding. 1/ Percentage of 1976 employment created by startups and expansions. 2/ Percentage of 1976 employment lost due to closings and contractions. 3/ Metro counties are those in metropolitan statistical areas (MSAs) designated by the Office of Management and Budget. Of 3,141 U.S. counties, 725 were metro (in MSA's) and 2,416 were nonmetro counties (outside MSA's). 4/ Small firms have fewer than 100 employees and large firms have 100 or more. Firm size refers to employment size of the entire company. The category "small corporate affiliates" refers to affiliates of firms whose employment in all operations, headquarters, and branches was less than 100 in 1976. 5/ New firms are those less than 5 years old in 1980; older firms are those 5 years of age or more in 1980.

Source: U.S. Establishment and Enterprise Microdata, 1976 and 1980, created by The Brookings Institution, Washington, DC, from Duns Market Identifier files, Dun and Bradstreet Corporation.

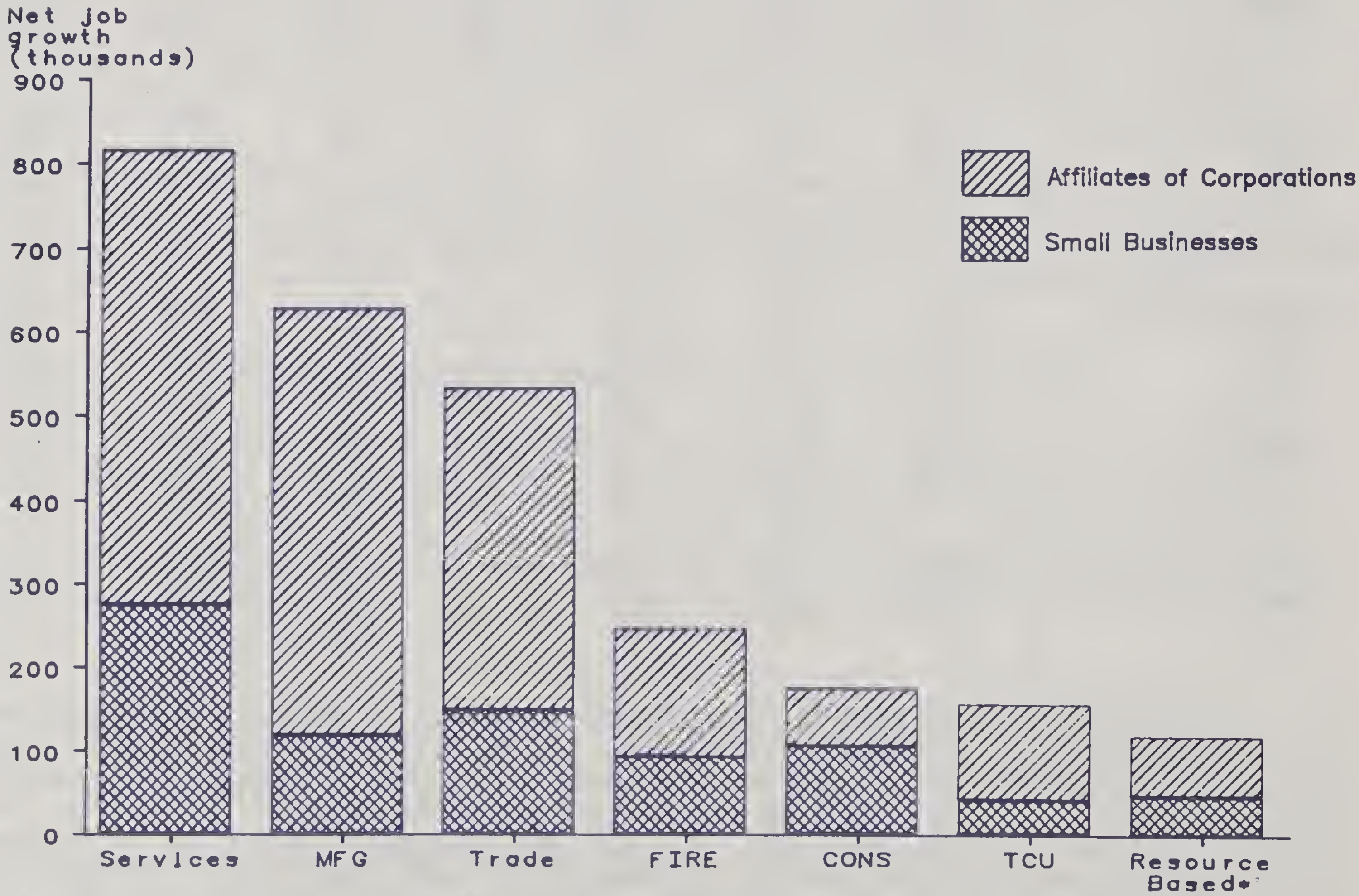
businesses--especially those just starting up--are more likely to locate in urban areas. Because of their small size and limited resources, many small businesses need access to urban facilities and service networks seldom found in rural areas; these include rentable office space, current information on customers and suppliers, legal and financial services, and a labor supply with the right blend of skills.[8]

JOB GROWTH AND STABILITY

Corporations in nonmetro counties created an additional 4 million jobs, about 49 percent of 1976 employment, through the birth and expansion of branches and subsidiaries between 1976 and 1980. At the same time, they lost a little over 2 million jobs (about 28 percent of 1976 employment) through closings and employment cutbacks (table 1). Small businesses created jobs at a slower pace (40 percent), but lost jobs at almost the same rate as corporations (26 percent).

Figure 1

Net Job Growth Attributed to Small Businesses and Corporations Nonmetro Counties 1976–80



*Agriculture, Forestry, Fisheries, and Mining.
NOTE: MFG (Manufacturing), FIRE (Finance, Insurance, Real Estate), CONS (Construction), TCU (Transportation, Communications, Utilities).

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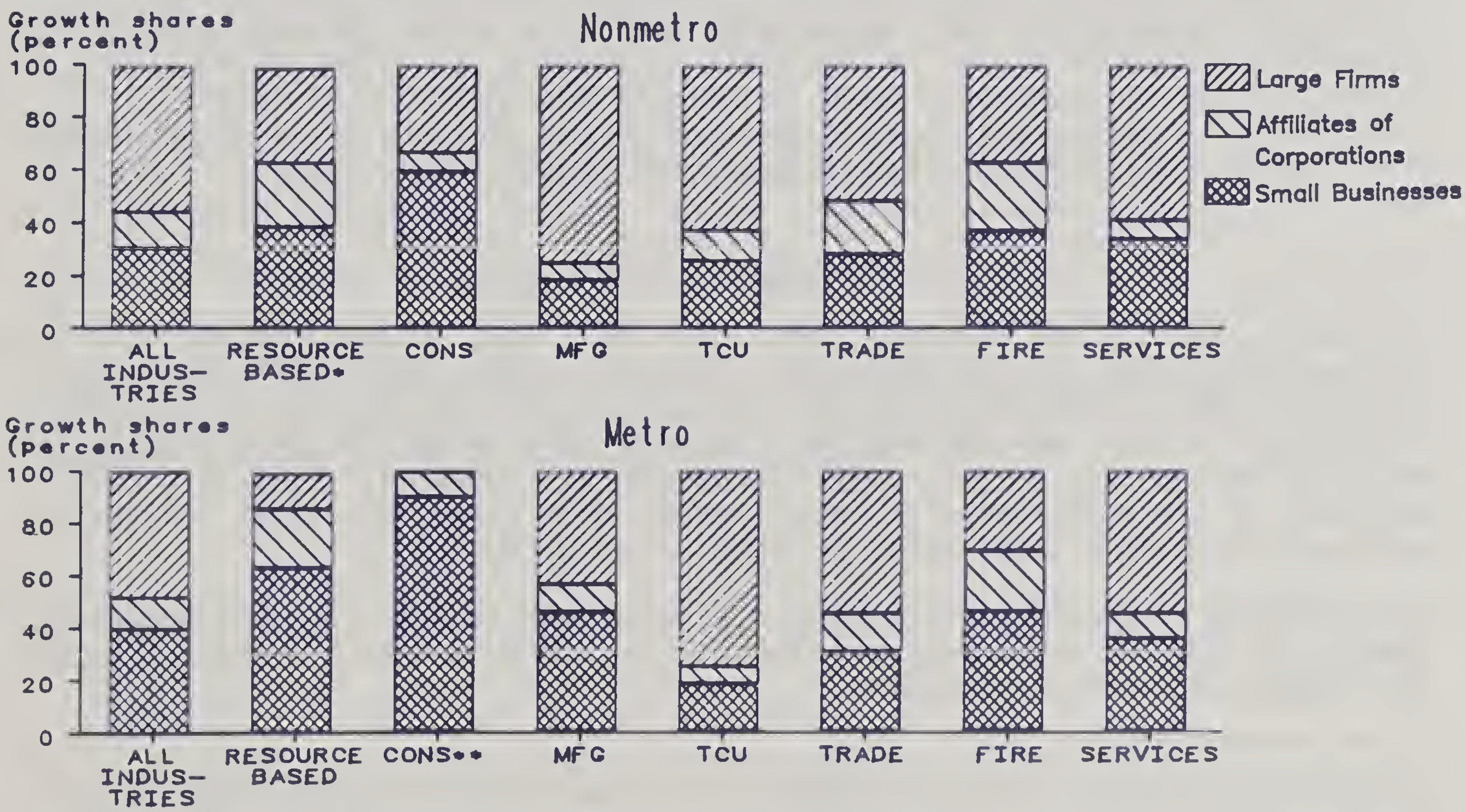
[8] For a good discussion of the "incubator hypothesis," see (14, pp. 109-114).

Small businesses in nonmetro areas had a somewhat higher turnover rate than did corporate affiliates. They initially generated many jobs, but subsequently lost jobs because many firms--after 5 years of operation--closed or cut back on hiring. Small independent firms less than 5 years old in 1980 expanded employment by 76 percent and accounted for 42 percent of all net new jobs in rural counties from 1976 to 1980. However, employment in older, small, independent firms actually declined 7 percent. Job losses due to closings and cutbacks (24 percent of 1976 employment) exceeded the number of jobs created by expansions (17 percent).

Independent firms with more than 100 employees generated fewer jobs in nonmetro counties than did small businesses, but these jobs were more stable, as measured by the number of jobs lost. The large, independent firms lost the lowest percentage of jobs through closings and cutbacks over 1976-80, 18 percent. Employment in older, large, independent firms declined 2 percent, less than the 7-percent decline in older, small businesses.

Jobs in large, independent firms were slightly less stable in metro than in nonmetro counties. The rate of employment decline due to closings and layoffs was 23 percent in metro counties, compared with 18 percent in nonmetro counties. In older firms, the gross decline was 22 percent in metro counties, compared with 16 percent in nonmetro counties. Unlike most large corporations, large, independent firms often have a vested interest in the rural community and its work force. Consequently, they do not lay off workers unless

Figure 2
Employment Growth Shares by Type of Firm and Industry
Metro and Nonmetro Counties, 1976-80



*Agriculture, Forestry, Fisheries, and Mining.
**Construction employment in large firms declined in metro counties.
NOTE: CONS (Construction), MFG (Manufacturing), TCU (Transportation, Communications, Utilities), FIRE (Finance, Insurance, Real Estate).

absolutely necessary. Their low job loss rate over 1976-80 may indicate a tendency to keep workers on the job even when it may be unprofitable to do so.[9]

Jobs in small businesses were equally stable in metro and nonmetro counties. The rate of employment decline attributable to closings and layoffs was approximately 26 percent in both county groups, nationwide.

Jobs in corporate affiliates, on the other hand, were slightly more stable in nonmetro counties. The nonmetro rate of corporate employment decline due to closings and cutbacks was approximately 28 percent, compared with 32 percent in metro counties.

One possible explanation for the employment stability in rural affiliates (the lower rate of gross employment decline) is that corporations, particularly in manufacturing, only gradually eliminated jobs over 1976-80, phasing out jobs at some facilities while expanding employment at the other rural locations. Almost all of the retrenchment in the manufacturing sector during the period occurred in metro areas where the branch plants in comparison with similar operations in nonmetro areas were (1) older and perhaps less efficient, (2) subject to higher union wages, and (3) more restricted by environmental regulations. Some corporate jobs in nonmetro areas undoubtedly were shifted to foreign locations, but this movement offshore has been a slow, long-term trend.[10]

Small businesses, on the other hand, continued to eliminate jobs by going out of business, which partially offset sizable job gains from the formation of new small businesses. Many probably failed during the "credit crunch" that occurred during 1978-80, a period of monetary restraint and rising interest rates. The high interest rates squeezed cash flows and aggravated the inherent or longstanding weaknesses emanating from inexperienced management and inadequate financing in many of these vulnerable small businesses, causing them to abandon expansion plans, reduce their work force, or go out of business. An unknown number of successful small businesses were merged with larger corporations. Employment sharply declined in the residual group of businesses that survived the first 5 years of operation as small businesses.

SUMMARY AND CONCLUSIONS

If job creation in the rural nonfarm sector is a goal of development policy and if small business is to be targeted by Federal, State, and local programs--enterprise zones, umbrella bond financing, and incubator facilities--then it is important for rural development practitioners to be aware of the stability as well as the quantity of jobs small businesses have created. They also need to be aware of the performance of large, independent firms, and small and large multi-establishment firms which we refer to as corporations.

Our analysis of microdata derived by the Brookings Institution from proprietary records of the Dun and Bradstreet Corporation, which covers a period of rapid employment expansion, indicates:

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[9] "Nonmetro area job losses in independent firms versus corporate affiliates" has been the subject of (3 and 9).

[10] The greater employment stability observed in corporate affiliates could also be attributed to corporate takeovers of small businesses. Many jobs in small businesses that appear lost in our tabulations may have been actually transferred to corporations by acquisitions and mergers.

(1) Small businesses (independent firms with fewer than 100 employees) provided about 31 percent of the net increase in private nonfarm jobs in nonmetro areas between 1976 and 1980. By contrast, affiliates of large corporations (multi-establishment firms) accounted for 68 percent during 1976-80. Large, independent firms accounted for only 1 percent of the new nonmetro jobs.

(2) Small businesses which had been in operation less than 5 years had extremely high turnover rates in both nonmetro and metro areas between 1976 and 1980. They created many jobs when new, but communities subsequently lost a sizable share of these jobs because of high failure and contraction rates. Even so, these small, new businesses accounted for over 40 percent of the net increase in private nonfarm jobs in both nonmetro and metro areas between 1976 and 1980.

(3) The microdata reveal a mixed picture about the relative importance of small businesses in nonmetro and metro areas. The share of private nonfarm employment in small businesses in 1976 was 36 percent in nonmetro areas, compared with 27 percent in metro areas. However, small businesses in nonmetro areas accounted for 31 percent of the 1976-80 increase in new jobs, less than the 40 percent in metro areas. Based on economic theory and previous urban studies, small businesses, especially the more innovative ones, would be expected to "incubate" better in metro than nonmetro areas because of the larger market and greater availability of specialized business services and goods.

The contribution of small businesses to rural employment growth may well be different during a period of rapid employment growth such as the period studied here, than during a period of sluggish growth which has occurred since 1980. Further research is needed to determine whether these patterns have been sustained through the early eighties.

Local planners, when mapping out an economic development strategy, should consider the advantages and disadvantages of both small businesses and affiliates of large corporations. Large corporations offer the potential for creating many new jobs in a single stroke. Yet, the shutdown of a large branch plant can devastate a small rural community. On the other hand, the creation of new and small local businesses can help rural communities expand employment, even though their failure rate is somewhat higher than for established businesses. Rural communities also can diversify their local industrial base and reduce their vulnerability to adverse developments in a single firm or industry by encouraging small business startups.

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